No. 10293

IN THE

United States

Circuit Court of Appeals

For the Ninth Circuit

R. E. LEE and STANDARD ACCIDENT AND INSURANCE COMPANY, a corporation,
Appellants,

vs.

UNITED STATES OF AMERICA,
Appellee.

REPLY BRIEF OF APPELLANTS

UPON APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF MONTANA

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MONTANA STANDARD, PRINTERS

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STATEMENT

We do not desire to amend the statement of the case made in our original brief. Appellee has seen fit to make a statement (Br. 2-4) which might be inadvertently misleading in one respect. We wish to point out again, and to emphasize again, that the United States contented itself at the time of trial with introducing in evidence only its exhibit No. 1, being a letter demanding payment of the bond within thirty day (R. 81-83). Thereupon it rested, basing its case upon the admissions in the answer and upon Exhibit No. 1. At the end of the defendants' case no rebuttal was offered. All evidence other than Exhibit No. 1 was introduced by the defendants.

ARGUMENT

I.

APPELLEE HAS TACITLY ADMITTED ERROR BY NOT ANSWERING THE CONTENTION THAT IT HAS FAILED TO PROVE THE MATERIAL ALLEGATIONS OF ITS COMPLAINT.

In our original brief we urged that the Government utterly failed to prove the material allegations of paragraph XII of the complaint alleging that the lessee "failed, refused and neglected to show cause, as required by said notice, within thirty days, or at all, why the said lease should not be cancelled" (Appellants' Brief 32-34). Appellee has nowhere sought to answer this argument. The argument cannot be brushed aside. It is founded upon, and based upon, the admissions, pleadings and proceedings of the Government itself.

We again wish to urge point III of the argument in our original brief (Appellants' Brief 32-34).

II.

APPELLEE'S TEST WELL ARGUMENT IS FALLACIOUS, AS WELLS REQUIRED BY LEASE WERE FOR PURPOSE OF DEVELOPING ENTIRE AREA.

Appellee's entire argument is based on the theory set forth in Section 1 of its brief (Br. 4). Appellee argues that because experts differ as to the probability of finding oil and gas, the lease requires the drilling of several regularly spaced test wells and that the United States had the absolute power to insist upon the drilling of four test wells in the first year.

A reading of paragraph 4 of the lease shows the fallacy of this argument and that all of the wells required by paragraph 4 were to "fully develop the land and extract the oil and gas therefrom".

Those familiar with oil and gas leases know that frequently a lease requires a test well before the lessee can surrender the lease. This is not that kind of a lease. It contains no provision for a test well. Lessee's right to surrender upon a showing of good cause would be exactly the same after one well, four wells, eight wells, or any other number of wells had been drilled.

The wording of paragraph 4 conclusively shows that there is no basis for appellee's contention that it had the absolute power to insist upon the actual drilling of four wells.

Paragraph 4 requires the lessee,

> "to drill at least four (4) wells on the premises within one year from date of such approval; and to drill four (4) wells during each successive year thereafter until as many wells have been drilled as there are 40-acre tracts or fractional parts thereof included in the lease; and thereafter to diligently drill such additional wells as may be necessary or proper in the judgment of the Secretary of the Interior to fully develop the land and extract the oil and gas therefrom, in accordance with the most approved methods of drilling development in the field where the lands are located."

The requirement was a specific one for the drilling of a sufficient number of wells *to fully develop the land and extract the oil and gas therefrom.*

Appellants' proof, which is not only uncontradicted, but which is entirely corroborated by the reports of

the United States Geological Survey, establishes the absence of oil or gas in the area, establishes the absence of the subject matter of the contract, and establishes good cause for the surrender and cancellation of the lease by the Secretary in accordance with the specific terms of the lease.

A lease is a contract. It is elementary that a contract must be read in its entirety and each provision construed in the light of the other provisions. One cannot consider the effect of paragraph 4 of the lease without at the same time considering paragraphs 7 and 8 and regulation 27. When read together, they unquestionably provide that the lessee can surrender the lease upon a showing of good cause.

In this case the lessee did surrender and show good cause, not only by his evidence but by the reports and recommendations of the United States Geological Survey. We again suggest that no better cause can be shown, that there will probably never be another case where the good cause is based not only on the lessee's evidence, but also on the evidence and recommendations of the geological representatives of the Interior Department.

There is nothing unusual or extraordinary about a lessee having the right to surrender. 1 *Thornton Oil and Gas (Willis)* 180, 181. Many oil and gas leases contain a provision to the effect that "lessee shall have the right, at any time on the payment of One Dollar ($1.00), to surrender this lease and the said premises and thereby be relieved from the performance of the terms hereof, thereafter to be per-

formed", or similar provisions. 7 *Summers, Oil and Gas* (1939) 202 (Mont.), 152, 32; 6 *Thornton, Oil and Gas (Willis)*, 2741 (Cal.), 2747 (Cal.), 2753 (Cal.), 2764 (Ind.), 2771 (Kan.), 2778 (Ky.), 2793 (N. M.), 2796 (Ohio), 2800 (Okla.), 2831 (Penn.), 2835 (Tex.). If a lessee did not have the right to surrender, he could be required to waste money, materials and manpower in useless drilling after there was no probability of producing oil or gas. 1 *Thornton, Oil and Gas (Willis)* sec. 101a.

The present lease, in paragraphs 7 and 8 and regulation 27, recognizes the accepted practice of giving a lessee the right to surrender, but imposes upon a lessee the burden of showing good cause for the surrender. Lee has shown good cause and the Geological Survey has shown good cause for him. The Secretary, having no other facts contrary to the showing of good cause, is not called upon to exercise any judgment or discretion and consequently must consent to the surrender of the lease.

When paragraph 4 is read as a requirement for the drilling of wells *to fully develop the land and extract the oil and gas therefrom*, instead of as a test well paragraph, appellee's arguments entirely fail because their foundation has disappeared.

III.

APPELLEE IS NOT IN A POSITION TO URGE THAT LESSEE FAILED TO SHOW GOOD CAUSE.

We have heretofore urged that good cause was shown by the lessee, that no better cause could have been shown, that the Secretary of the Interior denied

the lessee's application for surrender without any basis in fact or in reason upon which to justify his refusal and in clear disregard of the expert opinion and recommendation of the director and field officers of the Geological Survey. Appellee has tried to meet this argument by a half-hearted contention, half-hearted in part because it is difficult for the Government to justify the taking of such a position.

We assert that appellee is not in a position to urge that the lessee failed to show good cause. Paragraphs XI and XII of the complaint (R. 6-7) allege that Lee, the lessee, was given a notice in writing, "as provided in said lease", that the notice specified a time within which Lee was allowed "to show cause" why the lease should not be cancelled and the bond paid and that Lee failed, refused and neglected to show cause as required by the notice within thirty days, or at all. After taking this position in the complaint and setting forth these allegations as material, the Government then made a change of position which it maintained throughout the remaining proceedings in the case and throughout the trial.

By its motion for judgment on the pleadings the United States completely ignored the defendants' denial of paragraph XII of the complaint. The motion for judgment by the United States was made upon the theory that the Secretary of the Interior has untrammeled and unlimited power to refuse and deny the lessee's request for cancellation and surrender (R. 41-43). Apparently the United States at that time decided to take the position that para-

graphs XI and XII of the complaint were surplusage. Such is the position asserted in paragraph II (2) of the motion (R. 41). The same position is again emphasized in paragraph II (3) of the motion where the Government stated "that the requirement of consent implies the full and unqualified power to refuse the consent" (R. 42). In arguing the motion for judgment and in submitting a memorandum of points thereon, the Government held to its contention that the power of the Secretary to refuse the request for cancellation and surrender was an unqualified power. Consistent with this position, the Government's evidence at the trial was strictly limited to evidence of the giving of notice requiring payment of the bond.

No attempt was made by the Government to prove the allegations of paragraph XII of the complaint. Indeed this is understandable because from the Government's own files came the evidence that good cause had been shown. Indeed no better cause could have been shown to the Secretary in support of the lessee's application for cancellation and surrender.

Now apparently the United States would seek to change its position again, not directly but by the rather clever method of asserting that "even if the Secretary of the Interior had not reserved absolute power to insist on the drilling of four wells, his refusal to forfeit the bond cannot be considered arbitrary" (Br. 12). Even this alternative argument does not assist appellee. Appellee's argument in this respect is founded first upon a statement equally as arbitrary as the action of the Secretary. Appellee states:

> "It was certainly not arbitrary for the Secretary to decide that the facts and opinions offered by the lessee did not overcome reasonable doubt as to the non-existence of oil or gas (in the absence of extensive drilling)" (Br. 11).

Appellee's statement is entirely arbitrary. There is no evidence, no fact and no suggestion anywhere in the record that the Secretary *had* any reasonable doubt as to the non-existence of oil or gas. Indeed the facts and opinions offered by the lessee were entirely supported and corroborated by the director and field officers of the Geological Survey, who reported that the leased property had been adequately tested.

Appellee further urges that the wishes of the Tribal Council were consulted and their desires were considered reasonable. Appellee seems mistaken in several particulars. Appellee has asserted that paragraph 4 of the lease specifically states "that the wishes of the Tribal Council of the Indians will be consulted in matters affecting the lease of their lands" (Br. 12). An examination of paragraph 4 of the lease will disclose without question that consultation with the Tribal Council for the guidance of the Secretary was limited to one matter, namely, action upon an application for deferment of drilling and payment of annual rental (R. 14). Nowhere does it appear that the wishes and desires of the Indians give the Secretary room for the exercise of discretion. In paragraph 4 of the lease specific reference is made to the Secretary's power "in his discretion" to extend the time for drilling upon payment of annual rental. There is an entire absence

of such power, and there is an entire absence of any reference to the Indians, in paragraphs 7 and 8 of the lease and in regulation 27.

Again we urge that the desire of the Tribal Council that the bond be forfeited begs the question of whether good cause was shown to the Secretary. The wishes and desires of the Tribal Council are shown to have been "a resolution asking that the lease be cancelled for failure to comply with the drilling requirements" (T. 112). Again this is the very matter in issue. The desire or wishes of the Tribal Council can in this instance be given no greater status than that of a desire or wish to secure some easy money.

Looking to the wishes of the Tribal Council, the Government seeks to justify a change of position. It seeks to change a position asserted by its motion for judgment on the pleadings, by the limited nature of its proof and the failure to offer any evidence in rebuttal and by the nature of its proposed findings of fact and conclusions of law. The change is not supported in fact.

IV.

APPELLEE CANNOT READ PARAGRAPHS 7 AND 8 AND REGULATION 27 OUT OF THE LEASE OF ITS OWN DRAFTING.

The oil and gas lease here involved, and the regulations made a part thereof, were drafted by the United States. Nevertheless, appellee presents the anomalous argument that only paragraph 4 of the lease may be considered. Limiting attention to paragraph 4 and treating it as the only provision of the lease regulating drilling, appellee urges that the Secretary "ex-

pressly reserved in the lease under consideration the absolute power to insist upon the drilling of a specified number of test wells or the forfeiture of the bond for non-performance" (Br. 5). Were paragraph 4 the only provision of the lease relating to drilling, the contention would be sound, and we entirely agree that the lessor could have reserved the absolute power to insist upon the drilling of a specified number of wells. But it is specious to urge, as counsel for the appellee have done, that paragraph 4 is the only provision relating to drilling.

Introducing the entire argument, appellee has asserted that the Secretary of the Interior was cognizant of certain matters of common knowledge about the probability or improbability of finding oil or gas underlying a specific tract of land and that the lessor would want his land fully tested because each dry hole would increase the risk of not finding oil or gas and thus serve to discourage subsequent prospective lessees (Br. 4-5). No justification can be found in the record for such assertions. It does not appear that the Secretary was cognizant of these facts, or that they were facts. Indeed it specifically appears from paragraphs 7 and 8 of the lease and regulation 27 that the Secretary was cognizant of other matters. Paragraphs 7 and 8 and regulation 27 were drafted by the Government. They were present in the lease during all of its term and were present when the complaint was drafted and when paragraphs XI and XII were inserted in the complaint.

Contrary to the Government's present contention,

there were at least two occasions when the Government paid some attention to paragraph 8 of the lease and regulation 27. The Assistant Commissioner of Indian Affairs seems to have been guided thereby in his letter (Exhibit C to the complaint, R. 24-26) giving time and opportunity to the lessee within which "to show cause" why the lease should not be cancelled and the bond paid. Again in the drafting of the complaint, paragraphs XI and XII were inserted, alleging that the lessee failed, refused and neglected "to show cause" as required by the notice, or at all.

We urge again that paragraphs 7 and 8 and regulation 27 were inserted in the lease for a purpose and must be given a reasonable meaning. Again it must be specifically noted that paragraph 8 of the lease makes the regulations of the Secretary "a part and condition of this lease." Appellee's theory of absolute power eliminates every reason or occasion for the insertion of paragraphs 7 and 8 and regulation 27. Appellee's theory brushes aside the two occasions when the Government not only recognized but applied these provisions of the lease.

V.

REGULATION 27 DOES REQUIRE CANCELLATION BY THE SECRETARY FOR GOOD CAUSE SHOWN.

Appellee has made a curious argument regarding regulation 27. Appellee states:

> "A general regulation incorporated into the lease *in this indirect fashion*, should not be construed as dispensing with the express require-

ments of paragraph 4 * * * " (Br. 9) (italics ours).

Actually regulation 27 was specifically and directly incorporated into the lease under the terms of paragraph 8 of the lease which specified:

> "This lease shall be subject to the regulations of the Secretary of the Interior now or hereafter in force relative to such leases, all of which regulations are made a part and condition of this lease" (R. 17).

Not only was regulation 27 made a part of the lease but it was made a condition of the lease. The incorporation of the regulation was *direct and specific.* Indicative of the importance of regulation 27 as a part and condition of the lease is the fact that this particular regulation was substantially changed by order dated May 31, 1938. 6 *Summers Oil and Gas* (1942 Cumulative Pocket Parts), sec. 1013, pp. 114-115. The new regulation 27 now in effect (but adopted about four months after demand for payment of the bond was made upon the lessee and his surety in this case on February 3, 1938) eliminates the provision that "a lease will be cancelled by the Secretary of the Interior for good cause." Instead of this provision the new regulation specifies that upon the occurrence of ten detailed conditions the lessee "may, on approval of the Secretary of the Interior, surrender a lease or any part of it." Obviously this change bestows upon the Secretary of the Interior much greater power than he had under the old regulation in effect during all of the time of the lease here considered.

Urging that regulation 27 reserves to the Secretary

the determination of what constitutes good cause, appellee makes this flat assertion:

> "In fact regulation 58 discloses that the Secretary's decision 'shall be conclusive.'" (Br. 9).

We flatly disagree. Regulation 58 is as follows:

> "Failure to comply with any provision of the lease or of these regulations shall subject the lease to cancellation by the Secretary of the Interior or the lessee to a fine of not more than $500 per day for each and every day the terms of the lease or the regulations are violated, or the orders of the officer in charge pertaining thereto are not complied with, or to both such fine and cancellation, in the discretion of the Secretary of the Interior: Provided, That the lessee shall be entitled to notice and hearing with respect to the terms of the lease or of the regulations violated, which hearing shall be held by the officer in charge, whose finding shall be conclusive unless an appeal be taken to the Secretary within 30 days after notice of the decision of the officer in charge, and the decision of the Secretary of the Interior upon appeal shall be conclusive." 6 *Summers, Oil and Gas*, (1939) sec. 1013, p. 322.

This regulation, we submit, is not applicable to the present situation. The provision for hearing before a local officer in charge and appeal therefrom to the Secretary was not followed. Moreover, the only local officer in charge would seem to have been the field officer of the Geological Survey whose finding was favorable to the lessee and whose recommendation was specifically and directly disregarded by the Secretary of the Interior.

We urge that no better cause could have been shown by the lessee than was made in this instance.

The Geological Survey could not "justify any requirement for the additional three wells" (R. 88) and were "of the opinion that the lands * * * have been adequately tested" (R. 112). In the wording of the regulation ("will be cancelled by the Secretary of the Interior for good cause") no basis exists for the exercise of administrative discretion where there were no facts except those showing good cause.

VI.

PARAGRAPH 7 WHEN CONSIDERED WITH PARAGRAPH 8 AND REULATION 27 DOES NOT PERMIT THE SECRETARY OF THE INTERIOR TO EXERCISE UNTRAMMELED OR ARBITRARY JUDGMENT.

Appellee urges that "matters involving the judgment of the promisee are excluded from the 'satisfaction of a reasonable man' rule" (Br. 11). We agree. The question here presented to the Secretary was not one of judgment. It is not so stated in the lease or the regulations. The only approximation of the term "judgment" is used in paragraph 4 of the lease where it is specified that the Secretary may "in his discretion" extend the time to drill upon payment of annual rental. No such similar language is used in paragraph 7. The word "consent" there employed must be read and considered in connection with paragraph 8 and regulation 27. We refer again to our argument in the original brief (p. 38).

CONCLUSION

Points V, VI and VII of our original brief are covered by Appellee in such a way as to call for no reply (Br. 12-14).

We submit that the judgment of the District Court should be reversed and directions given for the entry of judgment for the defendants-appellants.

Respectfully submitted,

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